No. 15600

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

BETTY FINNEY and EDWARD F. FINNEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF

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JURISDICTIONAL FACTS

On January 16, 1957, the Tax Court of the United States rendered its decisions in T. C. Docket Nos. 51010 and 51011 (* R. 48, 49). These determined, respectively, that petitioner Betty Finney was liable for deficiency in her income taxes for the year 1945 in the amount of $3,938.98 and that petitioner Edward F. Finney was liable for deficiency in his

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* Transcript of Record.

ncome taxes for the year 1945 in the amount of $3,863.98. 1/

Petitioners are husband and wife who under the community property law provisions filed separate tax returns for the year in question (R. 74). The two cases had been consolidated in the Tax Court (R. 73), and petitioners on April 3, 1957, filed herein a joint Petition for Review of Decision and Order of the Tax Court (R. 50). Petitioners are citizens of the United States and reside in Los Angeles, California; their federal income tax returns which are here involved were filed with the Commissioner of Internal Revenue for the Sixth District of California, in Los Angeles, within the jurisdiction of this Court.

Jurisdiction of this Court to review the decisions of the Tax Court herein is founded on §7482 of the Internal Revenue Code (26 U. S. C. 7482).

Petitioners have been granted leave to file typewritten briefs.

1/ Though an alleged deficiency in each petitioner's income tax for the year 1944 was also originally in issue in the Tax Court, respondent ultimately conceded and the Tax Court decided that there was no deficiency in petitioners' taxes for 1944 (R. 48, 49). The proceedings before the Tax Commissioner and in the Tax Court are summarized in the Petition for Review, R. 51.

CONCISE STATEMENT OF THE CASE

For convenience the husband Edward F. Finney is hereafter referred to as the petitioner. Said Finney was engaged in various phases of the motion picture industry and his income and losses are reflected in both returns and are in issue here.

The petition (R. 50) raises the question of the correctness of the assessment of a deficiency of $3,863.98 in petitioner's 1945 income tax returns. The assessment rests on three separate items in petitioner's 1945 return. The Tax Court upheld the Commissioner's contention on each item. For convenience and in compliance with Rule 18 the general nature only of the resulting three questions is here set forth. A detailed statement of the facts concerning each question with appropriate record references precedes each legal argument. (See infra.)

The three questions involved are these:

(1) Was $10,824.00 received in 1945 from the film SENSATIONS OF 1945 (R. 29) ordinary income or a long term capital gain? 2/ These amounts were paid to petitioner in 1945

2/ Respondent has conceded that other amounts received from the film "Hi-Diddle-Diddle" similarly pursuant to the settlement agreement described in the text are taxable as long-term capital gain rather then ordinary income. In petitioner's view this immediately shows an inconsistency in the position of the Respondent.

ursuant to a settlement agreement dated Spetember 23, 1943 Pet. Ex. 2). The agreement effected the sale of petitioner's apital stock in Andrew Stone Productions, Inc., a California orporation in which he had been a minority stockholder. The ale was a complete and arms-length divestment of petitioner's nterest in the corporation, which interest he had acquired nore than six months prior thereto. The sale to the majority hareholders occurred at a time when the controlling share-olders required petitioner's shares possibly to effect a ubsequent dissolution of the corporation. Petitioner reported ne above amounts, which he received for his shares and for is interest in the venture as hereafter described, as a long erm capital gain. The Commissioner contended and the Tax Court held that these amounts constituted ordinary income R. 31). (See Argument, Part I, hereafter.)

(2) Did petitioners suffer a loss of $5,300.00 in 945 in connection with a film entitled STRANGE HOLIDAY? Petitioner had purchased this film in 1943. The film depicted n invasion of the United States by Nazi Germany. The defeat f Nazi Germany and the end of the war in 1945 rendered the ilm unmarketable and petitioner in his 1945 return reported a oss of his investment therein. The Commissioner contended nd the Tax Court held that petitioner had not proved a loss in 945, especially as he ultimately, in 1951, effected a sale hereof (R. 30). (See Argument, Part II, hereafter.)

(3) Did petitioner suffer a loss of $5,000.00 in 945 in connection with a film entitled WHITE FURY? etitioner had purchased this film in 1943. In 1945 petitioner as notified that his vendor had had no power or authority to ransfer title to the film, that the original producer and owner ad been adjudged a bankrupt in Sweden in 1939 and that the ilm had been sold pursuant to court order to the adverse laimant. In 1945 also the adverse claimant secured an in- unction against petitioner's exhibition of the film in England, etitioner was advised that his vendor could not satisfy any udgment, and petitioner's attorney advised petitioner that he ould not prevail in any litigation regarding title to the film. n his 1945 return, consequently, petitioner reported a loss f his investment in the film WHITE FURY. The Commis- ioner contended and the Tax Court held that petitioner had ot proved a loss in 1945, especially as he had not affirmative- y conceded the correctness of the adverse claim in 1945 nor ggressively pursued his claim against his vendor (R. 30). See Argument, Part III, hereafter.)

SPECIFICATION OF ERRORS

It is respectfully submitted that the Tax Court erred with respect to each of the three questions above set forth. Namely, the Tax Court erred:

(1) In holding and deciding that the amounts received by petitioner in 1945 from the film SENSATIONS OF 1945 as a result of the sale of his capital stock in Andrew Stone Productions, Inc., and in consequence of the settlement agreement with the majority shareholders thereof, dated September 23, 1943, did not constitute a long-term capital gain, as contended by petitioner, rather than ordinary income, as contended by the Commissioner.

(2) In holding and deciding that the film STRANGE HOLIDAY did not become worthless in 1945 and that petitioner was not entitled to deduct this loss in the taxable year 1945.

(3) In holding and deciding that petitioner's investment in the film WHITE FURY did not become worthless in 1945 and that petitioner was not entitled to deduct this loss in the taxable year 1945.

As will be seen in the legal argument hereafter, petitioner contends with respect to each of the above three specifications that the Tax Court erred:

(4) In that its conclusions, opinion and decision are not supported by and are contrary to the law, the evidence, its own Findings of Fact (R. 32-43) and other facts established by competent and uncontradicted proof which were not found by the Tax Court.

It follows from the above that petitioner contends that in its ultimate conclusions the Tax Court erred:

(5) In holding and deciding that taxpayer Betty Finney owes a deficiency in income tax for the year 1945 in the amount of $3,938.98; and

(6) In holding and deciding that taxpayer Edward F. Finney owes a deficiency in income tax for the year 1945 in the amount of $3,863.98.

ARGUMENT

I.

MONEYS RECEIVED FROM THE FILM SENSATIONS OF 1945 CONSTITUTE A CAPITAL GAIN RATHER THAN ORDINARY INCOME

A. Detailed Statement Of The Facts.

For convenience, Andrew Stone Productions, Inc., is hereafter referred to simply as "Productions".

The testimony dealing with petitioner's venture, Productions and the question above is found in the following pages of the Transcript of Record: 110-116; 152-199. The Findings of Fact of the Tax Court thereon are on pages 36-42. We believe the record is uncontradicted as to the following facts:

(1) Petitioner first met Andrew Stone about 1936 or 1937 (R. 152) and in 1941 or 1942 associated with Stone to make a picture for United Artists (R. 152-153). The third

venturer was Frederick Jackson. The three formed Productions, which was incorporated as a California corporation on September (or December) 16, 1942 (R. 110, 153).

(2) Petitioner had advanced $20,000.00 to the project (R. 110). Stock of Productions was ultimately issued 60 shares to Stone, 20 shares to Jackson, and 20 shares to petitioner; issuance was on January 8, 1943 (R. 110). The stock was purchased for $1.00 per share (R. 110). Each stockholder was also an officer, Stone being President (R. 153).

(3) Petitioner had agreements with Productions, Stone and Jackson (R. 156). They related to compensation and to stock purchase (R. 157), but his right to salary related only to his services with reference to the first picture of Productions (R. 159). The parties contemplated, however, that they would produce three or four or several pictures (R. 173, 179, 188-189).

(4) Petitioner was engaged as associate producer by Productions at a salary of $12,000.00, most of it deferred to be paid out of profits of the first picture (R. 111). Production on the first movie, "Hi Diddle Diddle", commenced about March, 1943 (R. 154) and the time of release was about August 20, 1943 (R. 154). Productions had a valuable distribution agreement with United Artists for this release (R. 154).

(5) Petitioner rendered various important services

n the production of "Hi Diddle Diddle", including arranging or financing (R. 194). He received $3,000.00 at the start of roduction and the remainder of his $12,000.00 salary from he proceeds of "Hi Diddle Diddle" during 1943, 1944, and 945 (R. 111-112). This money was reported as ordinary ncome and is not in issue here (R. 112).

(6) Petitioner also received from the proceeds of 'Hi Diddle Diddle" the return of the $20,000.00 he had dvanced plus 6% interest. This 6% interest he paid to the ank from which he had himself borrowed $20,000.00 (R. 182). This money is not in issue here (R. 114).

(7) Within two or three months of the formation of Productions, serious personal differences arose between Stone nd petitioner (R. 113).

(8) Stone and Jackson apparently desired to dissolve Productions and to assign its distribution agreement with United Artists to another corporation (R. 112, 155, 161, 192). United Artists would not have allowed petitioner to be unfairly excluded (R. 162).

(9) From May to September, 1943, petitioner, Stone and Jackson, each represented by attorneys, attempted to work out a settlement of their differences (R. 196). There were several drafts of agreements (R. 196). Ultimately an arms length settlement was worked out and embodied in the letter agreement dated September 23, 1943, which is

petitioner's Exhibit 2. For convenience, a copy of this agreement is Appendix A to this brief.

(10) At the time Exhibit 2 was executed, the distribution agreement of Productions with United Artists had not been assigned to another corporation (R. 196) and Productions had produced only one of the four pictures contemplated thereunder (R. 191, and Pet. Ex. 2).

(11) After petitioner sold his stock in Productions, it was in fact dissolved by Stone and Jackson (R. 154).

(12) The only other picture which Stone made under the United Artists agreement was SENSATIONS OF 1945. By the agreement of September 23, 1943 (Pet. Ex. 2) petitioner was to receive lump sum payments therefrom of $5,000.00 and $2,500.00 and 12% of the producer's net profits (see paragraphs (a) and (b) of Pet. Ex. 2; this percentage was later reduced). The moneys so received by petitioner in 1945 are in issue in this appeal. The above history and the meaning of Exhibit 2 are determinative of whether these moneys constitute ordinary income or capital gain.

B. The Transaction Shown Is An Arms Length Divestment of Petitioner's Interest In Productions and In His Joint Venture With Stone and Jackson.

We respectfully refer the Court to Petitioner's Exhibit 2, which is included herein as Appendix A. This agreement

f September 23, 1943, it will be seen, is not only an agreement by petitioner with Productions but also with Stone and ackson individually. It sets forth not only the sale of etitioner's stock in Productions, but also the complete ivorcement of petitioner from the activities of Stone and ackson. In short, it represents not only a sale of stock but lso a dissolution of a joint venture for the production and istribution of pictures -- a joint venture or partnership omposed of Stone, Jackson and petitioner.

The basic error of the Tax Court was in failing to see hat the consideration paid and promised to petitioner was for more than merely stock in a corporation which at that time ad produced only one picture. Rather, the consideration was also for his surrender of a partnership interest in a venture which not only had produced the one picture, but also had a valuable distribution agreement (R. 154, 183, 196), the services of skilled movie principals (Stone and Jackson; R. 176), and a projected life of three or four pictures (R. 170, 183, 189). To this venture, which antedated Productions, petitioner had contributed not only money in the form of a loan and capital, but also his services and know-how (R. 194), so that its assets and good-will were in part at least attributable to him.

The very language of Exhibit 2 shows that petitioner surrendered more than his stock, and that this more was a

partnership interest: The obligees of petitioner are Productions and Stone and Jackson; petitioner's return in question was to be from "producer's net profits ... of each of the next three motion pictures produced by Andrew Stone for release by United Artists under the existing distribution agreement ... " (Pet. Ex. 2, Par. (b)); petitioner was completely disaffiliated from Productions, Stone and Jackson so that he "shall not be obligated to render services of any nature whatsoever in the future and shall not be deemed to be an agent, partner, representative, associate or affiliate of yourself or any of the producing companies hereafter concerned with the production of said three motion pictures ... " (Ex. 2, Par. 4); petitioner, Stone and Jackson mutually released each other from all claims and rights (Ex. 2, Par. 6); the personal obligations of Stone and Jackson to petitioner were differentiated from the obligations of the corporation, Productions (Ex. 2, Par. 7).

That petitioner believed and contended this was what he parted with, albeit somewhat inartistically as he was in pro se, is apparent throughout the record. Thus when Exhibit 2 was first introduced the following was stated:

> "THE WITNESS: On the basis of that agreement, it is my contention that all of the money I received beyond the salary of $12,000.00 was capital gain because it was for the sale of stock which permitted the dissolution of the parent company and the following

activity of the subsequent organizations that were created.

THE COURT: Was that agreement carried out as --

THE WITNESS: This agreement was carried out as it is stipulated.

THE COURT: -- as it is spelled out in this Exhibit 2?

THE WITNESS: Yes, your Honor. May I say further, your Honor, that as you probably know, the company was dissolved, but the original intention when we formed Andrew Stone Productions, Inc., was to make a series of pictures, and we came to a complete disagreement about the second or third month of our activity, ... " (R. 113)

Similarly, it was explained that petitioner's agreements had been with Productions and with Stone and Jackson (R. 157-158).

And at the close of the Government's cross-examination the following was stated:

"Q. I will approach the matter in another way. Why would you have possibly have objected to the liquidation and dissolution of Andrew Stone Productions, Incorporated?

A. I objected to it in the beginning because

I had a 20 per cent interest in the company and was supposed to make a number of pictures, and that is what I wanted and why I joined up with Stone, and the reason we organized the corporation. I didn't want to see the thing dissolved. It certainly wasn't to my advantage.

I feel that I actually lost money in this situation. I lost a good amount. I lost an opportunity to make a great many pictures. I think that if Stone had acted differently, we would have made three or four pictures and that was the idea in back of the whole proposition.

Q. So that what you received in Exhibit 2 was not only the value of your stock but also your value in the right to participate in the profit of future motion pictures.

A. I did receive the participation right.

Q. What you received was in lieu of or for the right you had to participate in the profits of future motion pictures. If I am not clear to you, state it and I will try to rephrase my question. Would you like me to rephrase the question?

At the time of the agreement, you not only held twenty shares of stock in a corporation known as Andrew Stone Productions, Incorporated, but you also possessed a right to share in the net proceeds of

approximately three to four motion pictures to be produced by a group of Stone, Jackson, and yourself under United Artists distribution agreement.

A. That is correct." . . . . (R. 188-189)

The Tax Court, however, felt that the controlling matter was that petitioner, by Exhibit 2, received his "full 20%" of the proceeds of the one picture which had been produced by Productions ("Hi Diddle Diddle"). To the Tax Court this meant that any additional receipts by petitioner could not be in return for the surrender of his 20% interest in the corporation and therefore had to be ordinary income. At pages 172-173 of the Record the Court stated:

"THE COURT: So that you didn't diminish the amount that you would receive on High Diddle Diddle. You got your full 20 per cent on that.

THE WITNESS: But essentially I had 20 per cent of anything that might be made. That was the idea of the corporation in its original organization.

THE COURT: I don't see how that can be if you had severed your connections with the corporation.

THE WITNESS: I didn't sever my connections. I was forced out of it, and I had no choice in the matter."

To the same effect, see the colloquy between the Court and petitioner on pages 189 - 192, including the Court's

comment:

"THE COURT: The question I have to answer is whether it was a bona fide stock sale or whether there was more to it than meets the eye.

The explanations that have been given I must say up to this point leave me in doubt." (R. 191-192)

C. The Sale Of a Partnership Interest Is The Sale Of a Capital Asset And The Proceeds Thereof Constitute a Capital Gain and Not Ordinary Income

The Tax Court concluded in line with its thinking as above shown that since more than the sale of stock in Productions was involved, the moneys received (in excess of the 20% of "Hi Diddle Diddle") could only be ordinary income.

As shown, however, the Tax Court's approach ignores the fact that the more which was surrendered was a partnership interest; such an interest is a capital asset and the proceeds of its sale constitute a capital gain and not ordinary income.

United States v. Shapiro, 178 Fed. 2d 459 (8th Cir. 1949)

Commissioner v. Smith, 173 Fed. 2d 470 (5th Cir.) cert. den. 338 U. S. 818 (1949)

Commissioner v. Shapiro, 125 Fed. 2d 532 (6th Cir. 1942)

McClellan v. Commissioner, 117 Fed. 2d 988 (2nd Cir. 1941)

Dudley T. Humphrey, 32 B. T. A. 280 (1935)

G. M. C. 26379, 1950-1 Cum. Bull. 58
(citing additional cases)

As the bulletin of the Commissioner above cited concedes, "It is accordingly the opinion of this office that the sale of a partnership interest should be treated as the sale of a capital asset under the provisions of section 117 of the Internal Revenue Code." 3/

The rule that the sale of the partnership interest is to be treated as a whole as a capital asset is not to be avoided here simply because one asset of the partnership, namely, the corporate form through which it was working at inception, is identifiable and of determinable value. Rather, the law is clear that where a joint venture or partnership operates through a closed corporate form, the joint venture still survives as between the members:

Foster v. Keating, 120 Cal. App. 2d 435, 445-447, 261 Pac. 2d 529 (1953)

Elsbach v. Mulligan, 58 Cal. App. 2d 354, 368-370, 136 Pac. 2d 651 (1943)

Hillman v. Hillman Land Co., 81 Cal. App. 2d 174, 183-185, 183 Pac. 2d 730 (1947)

As said in the Elsbach case, supra, 58 Cal. App. 2d at 370: "In this case the resort to the corporate mechanism cannot efface the true purpose of the original joint venture." Here

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3/ The sections referred to herein are of the 1936 Internal Revenue Code, which controls this case.

Stone and Jackson had to purchase from petitioner not only his share of the stock of Productions but also his interest in the joint venture as originally contemplated. It follows that the fact that part of the consideration received by petitioner (20% of "Hi Diddle Diddle") under the contract of September 23, 1943 (Exhibit 2) can in theory be allocable to the value of his shares of stock in Productions (as the Tax Court believed), does not prevent the remainder of the consideration received by him from also being paid for his partnership interest. This is so because his partnership interest -- what he sold by the contract Exhibit 2 -- included more than merely his ownership of 20% of Productions. It included an interest in the goodwill, 4/ facilities and talents of Productions and of Stone and Jackson, including a right to participate not only in the productions and profits of "Hi Diddle Diddle" but also in the production of three or four additional films to be produced by Stone (not Productions) and to share in the proceeds thereof. It is no wonder, therefore, that petitioner demanded and

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4/ "Goodwill is a capital asset and any gains resulting from the sale thereof are capital gains." Horton v. Commissioner, 13 T. C. 143, 149 (1949). Michael v. Commissioner, 12 T. C. 17 (1949); Wyler v. Commissioner, 14 T. C. 1251 (1950); Franklin v. Commissioner, 6 T. C. M. 1099 (1947). That the gains are paid in deferred percentage payments does not change their character to ordinary income. Horton v. Commissioner, supra. In Franklin v. Commissioner, supra, weekly payments of $75.00 for the use of the taxpayer's name in the business she sold were held to be for goodwill and taxable only as a long term capital gain.

received as consideration for the sale of his stock and of his entire claim and right against Stone and Jackson interests greater than merely 20% in "Hi Diddle Diddle", the only film then completed.

What was said in Swiren v. Commissioner, 183 Fed. 2d 656, 660 (7th Cir. 1950), is applicable here, though the facts there are not ours:

> "The Commissioner and the Tax Court, while correct in part in regarding as a capital asset taxpayer's unrecovered net investment and allowing recovery therefor in full amount, failed to recognize that, as a matter of law, taxpayer's partnership interest as a whole was a capital asset within Sec. 117 of the Internal Revenue Code, with the gain attending the sale thereof taxable as a capital gain, and not otherwise." (Emphasis added)

The rule that consideration paid for the transfer of a partnership interest is taxable as a capital gain is not vitiated here by the fact that the consideration in part was deferred and was to be paid out of subsequent operations of the purchasing joint-venturers.

Burnet v. Logan, 283 U.S. 404 (1931)

Commissioner v. Carter, 170 Fed. 2d 911 (2nd Cir. 1948)

Westover v. Smith, 173 Fed. 2d 90 (9th Cir. 1949)

Commissioner v. Hopkinson, 126 Fed. 2d 406 (2nd Cir., 1942)

United States v. Yerger, 55 Fed. Supp. 521 (ED Pa. 1944)

George James Nicholson, 3 T. C. 596, 601-602 (1944)

Illustrative of these cases are the following:

In Commissioner v. Carter, 170 Fed. 2d 911 (2nd Cir. 1948), the sole stockholder of a corporation received on its liquidation, in addition to other assets, the rights to certain oil brokerage contracts providing for payment of commissions on future deliveries by named sellers to named buyers. These contracts, like petitioner's rights in future pictures of Stone here, then had no ascertainable fair market value. The other assets received on the liquidation exceeded the basis for the stock, and capital gain resulted on the liquidation (per §115(c) of the 1939 Code, which is not involved in petitioner's case under our analysis here). The court held with the taxpayer that as payments were received on the brokerage contracts, such payments constituted capital gain and not ordinary income, since if the contracts could have been valued when received on liquidation, such value would have produced capital gain.

In Westover v. Smith, 173 Fed. 2d 90 (9th Cir., 1949),

facts were generally similar to the Carter case, supra, and the reasoning and holding there were specifically approved by this Court. The contract involved was one where for the sale of assets the seller received "cash and the right to receive 10% of the gross sales price of machinery to be manufactured and sold by Whiting Corporation, pursuant to patents theretofore held by Quickwork Company." (173 Fed. 2d at 91) This Court stated:

> "In such a situation the only practicable and accurate method of measuring the contract's value is through the application of money to such valuation as it is received." (173 Fed. 2d at 92)

It was held that the payments should be taxed as capital gain.

In United States v. Yerger, 55 Fed. Supp. 521 (ED Pa. 1944), a business was sold for a consideration consisting of cash equal to the basis of the assets, plus a percentage of the profits of the business for the next five years. It was held that the profits so paid to the seller would be taxable only when received, and at capital gain rates. At 522 of 55 Fed. Supp. the Court stated:

> "It is well settled that where capital assets are transferred to a corporation in consideration for a price which is to be paid in installments, or out of profits, or upon a

unit basis, such payments are capital in character as distinguished from income."

Additional cases, the progeny of Burnet v. Logan, 283 U.S. 404 (1931), have been well summarized in N.Y.U. Sixth Annual Institute on Federal Taxation (1947), at pages 475-476.

D. Even Assuming That Petitioner Has Shown Only the Sale of Stock in Productions and Not a Sale of a Partnership Interest in Addition, the Moneys Received from the Film SENSATIONS OF 1945 Constitute A Capital Gain Rather Than Ordinary Income.

Under this heading we accept, aguendo only, what appears to be the premise of the Tax Court's reasoning, namely, that petitioner had only his 20% interest in Productions to sell as a capital asset. This premise nevertheless does not require a holding that moneys received beyond the 20% return to petitioner from "Hi-Diddle-Diddle" were ordinary income.

First we point out that the ultimate findings of the Tax Court are simply that the amounts received by petitioner from SENSATIONS OF 1945 were consideration for the sale of his stock in Productions. The findings conclude as follows:

"The amounts received by petitioner on account of 'Sensations of 1945' represent

amounts received as consideration for the sale or transfer of his shares of stock in Productions. They are not proceeds from the sale or exchange of capital assets, and are taxable as ordinary income." (R. 43)

We submit that on its face the conclusion is not supported by the finding. The law is crystal clear that unless one is a dealer selling to customers, gains and losses from the sale of shares of stock are capital.

Commissioner v. C. A. Sporl & Co. 118 Fed. 2d 283 (5th Cir. 1941)

Commissioner v. Burnett, 118 Fed. 2d 659 (5th Cir. 1941) and numerous cases there cited.

Thus, the consideration received for the sale of petitioner's capital asset -- shares of stock in Productions -- cannot be ordinary income. (The fact that the consideration was deferred does not, as shown by the cases cited above on page 20, change the nature thereof: it still remains a capital gain.)

Taking the Tax Court's ultimate findings on their face, therefore, there must be a reversal without more.

Out of an excess of caution, however, we discuss the Tax Court's conclusion on the premise that it rested on the Tax Court's belief that petitioner's shares of stock

could not be given a value greater than a twenty percent interest in HI-DIDDLE-DIDDLE, the only film in existence at the time of his sale. We do so because it is apparent that the Trial Court believed that when majority shareholders buy out a minority shareholder, as here, the latter is restricted in the consideration paid him for his stock to an amount equal only to his pro-rata interest in a particular tangible asset which the corporation may then have. That is, the Tax Court reasoned that since Productions had produced only HI-DIDDLE-DIDDLE at the time of the sale of petitioner's stock, Stone and Jackson could or would pay him for his capital asset (stock) only an amount from HI-DIDDLE-DIDDLE proportionate with his interest in the corporation. As the Tax Court put it: "So that you didn't diminish the amount that you would receive on High Diddle Diddle. You got your full 20 per cent on that." (R. 172) This too was the Government's approach:

> "... Andrew Stone alone could have liquidated it [Productions] and dissolved the corporation. If he had done so, the only asset distributed was High Diddle Diddle or the net proceeds from reproduction or exhibition of High Diddle Diddle, which means that you could have received no more than 20 per cent of the net proceeds of High Diddle Diddle.
>
> * * *

" ... Your stock would only be worth 20 per cent of the net proceeds of High Diddle Diddle ..." (R. 178-179)

This approach, however, overlooks what legally must be controlling here:

(a) The sale of petitioner's stock to adversary shareholders in an arm's length transaction cannot be equated with a dissolution of the corporation and a distribution of its assets pro rata to him. Rather, it must remain simply a sale of stock: Stone and Jackson purchased petitioner's stock to obtain for themselves complete control of Productions so that they could do with Productions what they wished. It is true that it appears that shortly thereafter Productions was dissolved by Stone and Jackson (R. 154, 196), but this subsequent event to which petitioner was not a party cannot retroactively determine that the value of petitioner's stock, to Stone and Jackson or to anyone else, was only his pro rata interest in the single film Productions then had.

(b) In fact, of course, Productions had assets in addition to HI-DIDDLE-DIDDLE. At the time of petitioner's sale of his stock, Productions was a going corporation with contemplated future production. It had a valuable asset in a distribution contract with United Artists (R. 154, 183, 196). It had valuable talent, Stone and Jackson, available to it (R. 153, 193). It had established lines of credit (R. 156, 194).

In short, realistically and legally there is absolutely no basis for holding that the value of petitioner's shares of stock therein must be determined solely by reference to the one film it had then completed.

(c) It is no answer to (a) and (b) above to contend, as the Government did in the Tax Court, that Stone and Jackson could have dissolved Productions regardless of petitioner's interest therein and could thus have forced him to receive in dissolution only his proportionate share from HI-DIDDLE-DIDDLE. (See R. 178-179). This is no answer because, in fact, petitioner as a minority shareholder could have prevented dissolution of Productions by Stone and Jackson except through a protracted court proceeding. 5/

The pertinent California statutory provisions in 1943 were the then sections 399 through 404c of the Civil Code, which are respectfully called to the Court's attention. It is true that they provided for the commencement of voluntary dissolution by the vote or consent of 50% or more of the voting power (§400). But dissolution could not be effected and distribution to shareholders could not be made until "all

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5/ Beyond that, since at the time of Exhibit 2 petitioner was also a creditor of Productions, he could have wholly prevented dissolution of Productions until he was fully paid his salary on "Hi-Diddle-Diddle" and repaid the moneys he had loaned to Productions. See Cal. Civil Code §401a as it existed in 1943.

the known debts and liabilities of a corporation in the process of winding up have been paid or adequately provided for ..." (§401a) 6/ Liability for improper distributions was imposed on the shareholders. (§402). More important, and directly pertinent to the power which petitioner had as a minority shareholder, was §403:

> "If a corporation is in the process of voluntary winding up, the superior court in and for the county where the principal office of the corporation is located, upon petition of the corporation or the holders of five percent or more of the number of its outstanding shares or of three or more creditors, upon such notice to the corporation and to other persons interested in the corporation as shareholders or creditors as the court may order, shall have power to order and adjudge as to any or all matters in and for the winding up of the affairs of the corporation including:

6/ The section in part further provided: "The payment of a debt or liability shall be deemed to have been adequately provided for if the payment thereof has been assumed or guaranteed in good faith by one or more financially responsible corporations or other persons, and such provision was determined in good faith and with reasonable care by the board of directors to be adequate at the time of any distribution of the assets by the directors hereunder."

(1) The presentation and proof of all claims and demands against the corporation ...

(2) The settlement or determination of all claims of every nature against such corporation or any of its property, ...

(3) The determination of the rights of shareholders and of all classes of shareholders in and to the assets of the corporation.

(4) The presentation and the filing of intermediate and final accounts of the directors and hearings thereon, and the allowance, disallowance or a settlement thereof, and the discharge of the directors from their duties and liabilities.

(5) The appointment of a referee to hear and determine any or all matters with such power or authority as the court or judge may deem proper.

(6) The filling of any vacancies in the number of directors which the directors or shareholders are unable to fill.

(7) The removal of any director if it is made to appear that he has been guilty of dishonesty, misconduct, or abuse of trust in conducting the winding up, or if he be unable to act ...

(8) The notices to be given of any hearing or order ...

(9) Staying the prosecution of any suit . . .

(10) Determining whether adequate provision has been made for payment or satisfaction of all debts and liabilities not actually paid.

(11) The revocation of the election to wind up and dissolve by the shareholders, and the making of orders for the withdrawal and termination of proceedings to wind up and dissolve, subject to conditions for the protection of shareholders and creditors.

(12) The making of an order, upon the allowance or settllement of the final accounts of the directors, that the corporation has been duly wound up and is dissolved. Upon the making of such order, the corporate existence shall cease except for purposes of further winding up if needed.

(13) Any and all other matters concerning the winding up of the affairs of the corporation."

(Emphasis added)

The comparative simplicity of a voluntary dissolution without court proceedings can be seen by contrasting the above with the provisions of the then §403c(1) of the California Civil Code, which in effect gave the majority of the Board of Directors a free hand in the dissolution process and required

only the filing of a certificate of dissolution. 7/

7/ §403c(1) then read:
"When a corporation has been completely wound up without court proceedings therefor, a majority of the directors or trustees shall sign and acknowledge a certificate stating:

(a) That the corporation has been completely wound up.

(b) Whether its known debts and liabilities have been actually paid, or adequately provided for, or paid as far as its assets permitted, or that it has incurred no known debts or liabilities, as the case may be.

(c) Whether its known assets have been distributed, or wholly applied on account of its debts and liabilities, or that it acquired no known assets, as the case may be.

Such certificate shall be filed in the office of the Secretary of State and thereupon corporate existence shall cease except for the purpose of further winding up if needed. A copy of the certificate certified by the Secretary of State shall be filed in the office of the county clerk of the county in which the principal office of the corporation is located.

Before any corporation taxed under the Bank and Corporation Franchise Tax Act may file a certificate of dissolution it must file or cause to be filed with the Secretary of State the certificate of the Franchise Tax Commissioner provided for by Section 29 of said act."

(As amended at the 1943 Legislative session and in effect August 4, 1943. Prior to such amendment the section was even simpler and less onerous than above in the requirements of its certificate.)

If, therefore, the parties hereto may speculate as to whether dissolution of Productions was the purpose of Stone and Jackson in purchasing petitioner's shares, it follows that such purpose would increase rather than restrict the value of petitioner's shares to them; for only if they bought petitioner out would they have a free hand in the dissolution of Productions. If they did not buy him out, he could prevent or greatly delay dissolution and could require its strictest supervision by the California court. The value of his shares to them, therefore, greatly exceeded his proportionate interest in HI-DIDDLE-DIDDLE.

(d) The above analysis of the value of petitioner's shares in Productions cannot be avoided by the assertion that petitioner's interest in the additional films was given to him for the release of his rights under an employment contract. In the first place, the Tax Court's ultimate finding was simply that the moneys from SENSATIONS OF 1945 represented consideration for petitioner's stock, and not consideration for the release of a salary right. In the second place, petitioner testified he had no contract right to employment on future films:

> "Q. Will you explain to the Court what was your provision for salary-compensation as to future motion pictures produced by either Productions Corporation or by any other

corporation, in which Mr. Stone or Mr. Jackson were stockholders or controlling stockholders.

A. At that time, no arrangement had been made for future salaries. I presume that would have been arranged once the picture had gotten underway, the subsequent picture, but as I explained to you, in the middle of High Diddle Diddle, we had this disagreement, so we never got into salaries or future pictures.

THE COURT: Did the $12,000 salary relate to that one picture?

THE WITNESS: Related to the one picture, yes, your Honor." (R. 158-159)

As petitioner put it, "The only right I had was the right of a stockholder." (R. 159-160)

If the ultimate finding of the Tax Court be accepted -- that the amounts received from SENSATIONS OF 1945 were consideration for the sale of petitioner's stock in Productions -- the judgment must be reversed without more.

If the Court can consider the apparent premise of the Tax Court that the value of petitioner's stock could only be equal to 20% of the return from HI-DIDDLE-DIDDLE, the judgment must nevertheless be reversed for the reasons stated in D above.

If the Court believes that the record truly shows that more than petitioner's stock was sold or transferred, the judgment must nevertheless be reversed for the reasons stated in B and C above.

We conclude that in any event the judgment of the Tax Court that the amounts received from SENSATIONS OF 1945 constituted ordinary income was erroneous.

II

THE MOTION PICTURE "STRANGE HOLIDAY" BECAME WORTHLESS IN 1945 AND PETITIONER WAS ENTITLED TO DEDUCT THIS LOSS IN 1945

A. Detailed Statement of the Facts.

The testimony dealing with the motion picture STRANGE HOLIDAY is found in the following pages of the Transcript of Record: 83-99; 118-132. The Findings of Fact of the Tax Court thereon are on pages 33-34. We believe the record is uncontradicted as to the following facts:

(1) The film STRANGE HOLIDAY was made by General Motors during the middle of the war. General Motors sold it to M. G. M., and in 1943 petitioner purchased the film from M. G. M. for $4,000.00 (R. 84-85). The film dealt with a Nazi invasion of the United States (R. 83-84). "The picture is very much preachment, and long scenes, perhaps a reel and a half or more at a time, are given to Rains in a cell where he had been thrown by the Nazi faction and subjected to all sorts of cruelties." (R. 93-94).

(2) "So that the film would be qualified for general presentation in the theaters," (R. 84) petitioner thereafter expended $6,300.00 for actors, laboratory work, reediting and kindred production expenses. (R. 85) The bulk of these

expenditures were in 1944. Expenditures in 1945 were of small amounts and no work was done on the film or expenses incurred thereon after the summer of 1945. (See R. 122) 8/

(3) The surrender of Nazi Germany occurred in May, 1945; the end of the war occurred in August, 1945. (R. 152) " ... no comparable picture ... has been made since then." (R. 132)

(4) Petitioner's desperate efforts (R. 94) to obtain distribution and booking of STRANGE HOLIDAY in 1945 were uniformly unsuccessful, despite the fact that he dealt with several distributors including those who specialized in such features. (R. 90-94) His lack of success, of course, is relevant to show the worthlessness of the film in 1945.

(5) Petitioner was informed in 1945 by all the distributors and experts he contacted that in their opinion the film STRANGE HOLIDAY was then worthless. Assuming that such opinion is hearsay and not admissible to prove the ultimate fact of worthlessness (see the Government's objection, R. 91), nevertheless petitioner's testimony concerning such other opinion was admissible to prove petitioner's state of mind concerning the value of the film in 1945. Such state of mind is relevant and of considerable importance in determining whether he is entitled to a loss in 1945. As stated in

8/ The Court's opinion states, "In fact, work continued and sums were expended on that picture until August of 1945." (R. 43)

Boehm v. Commissioner, 326 U.S. 287, 293, "The taxpayer's attitude and conduct are not to be ignored . . ."

(6) At the end of 1945 petitioner "wrote the thing off completely" (R. 129) and a physical entry to that effect was then made in his books of account. (R. 129)

(7) After 1945 the film was simply stored at a laboratory and petitioner paid no storage charge whatsoever. (R. 128).

(8) Until the end of 1945 petitioner carried insurance on the film; after 1945 he carried no insurance thereon (R. 129)

(9) No loan was ever sought against the film, and its salvage value was a mere $10.00 (R. 130)

(10) After 1945 petitioner made no concerted efforts to sell any rights in the film. As he put it, "We practically abandoned the picture in '45" (R. 122). The subsequent realization of $2,100.00 therefrom in 1951 was the result of a casual conversation and not the result of a continuous or any effort to sell the film. (See R. 123-125) 9/

(11) For over five years after the film became

9/ We are aware that the Tax Court findings contain the sentence "Thereafter, he kept the picture in storage but without payment of storage fees, and made constant but non-intensive efforts to sell or distribute it." (R. 33. See also opinion p. 44.) We believe that upon analysis of the record the latter part of this finding cannot stand. See argument infra.

worthless petitioner did not realize a penny from it. (R. 94-95) When ultimately petitioner did realize $2,100.00 therefrom in 1951 (which he reported as ordinary income, R. 95), it was only because a third person invested over $20,000.00 in the film for extensive changes in an effort to change its Nazi theme. (R. 95-97). Petitioner himself expended nothing on the film in 1951 when he ultimately disposed of it. (R. 132).

B. The Record Clearly Shows the Loss To Have Occurred in 1945.

Petitioner is aware that the Tax Court found that "'Strange Holiday' did not become worthless in 1945." (R. 42). Petitioner is also aware that "Whether and when a deductible loss results ... is a factual question ... to be decided according to the surrounding circumstances." Alison v. United States, 344 U.S. 167, 170 (1952). Petitioner nevertheless respectfully urges that this record cannot sustain the "finding" of the Tax Court, and that a loss under Section 23(E) of the 1939 Code is clearly shown.

Every one of the eleven items listed above under the Detailed Statement of the Facts points irresistibly towards the worthlessness and abandonment of STRANGE HOLIDAY in 1945. Items (1), (2), (3), (4) and (5) above establish the nature of the film and the destruction of its value both objectively and subjectively by the end of the war and by the

public's changed mood. See R. 84. Items (6), (7), (8), (9) and (10) above clearly establish that petitioner closed the transaction on his books and abandoned the film as a matter of fact in 1945.

Item (11) -- no return for five years and then a chance realization of a small part of petitioner's investment -- emphasizes the worthlessness in 1945. In 1945 petitioner was not entitled to speculate that in the distant future some unknown use for the footage might turn up. On the contrary, in 1945 after the termination of the war and in the face of a completely negative response from distributors and experts in the field, petitioner was not required to be "an incorrigible optimist."

United States v. S. S. White Dental Co., 274 U. S. 398, 403

Niagara Share Corp. v. Commissioner, 82 Fed. 2d 208, 211-212 (4th Cir., 1936)

Commissioner v. John Thatcher & Son, 76 Fed. 2d 900, 902 (2nd Cir., 1935)

Commissioner v. Highway Trailer Co., 72 Fed. 2d 913, 914-915 (7th Cir., 1934)

Cahn v. Commissioner, 92 Fed. 2d 674, 676 (9th Cir. 1937)

Against the above array of uncontradicted evidence, the Tax Court found that a loss did not occur in 1945 (1) because petitioner expended some moneys on STRANGE HOLIDAY in 1945 after the end of the war with Germany

(R. 33, 43) and (2) because he made "constant but non-intensive efforts to sell or distribute it" (R. 33, 44) and did sell it in 1951 (R. 30).

The first reason of the Tax Court, however, is clearly specious and improper on its face: unless petitioner attempted to sell or distribute his film after the end of the war with Germany he could not claim or show that that event had rendered it valueless. The end of the war and the concommitant change in public attitude did not stamp an imprimatur of worthlessness on the film without more. It was only after further expenditures in 1945 to August or thereabouts and after intensive efforts to sell or distribute the film after the end of the war in 1945 that petitioner and the industry became convinced that the film had been rendered valueless. To give petitioner's expenditures in 1945 any other legal effect is to preclude a taxpayer from taking any steps to realize upon an asset which the events of history may have withered. "The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test." Lucas v. American Code Co., 280 U. S. 445, 449. Just as the taxpayer is not required to be an incorrigible optimist, he is not permitted to be an incorrigible pessimist. See:

Lucas v. American Code Co., 280 U. S. 445, 450-452 (1930)

First Nat. Corp. v. Commissioner,
147 Fed. 2d 462, 464 (9th Cir. 1945)

The second ground for the Tax Court's holding is, we submit, unsupported on this record. It is true that petitioner on pages 95 and 98 of the Record testified he had been making efforts "constantly" to dispose of the picture during 1945-1951. But his use of that word and the word "concerted" was explained at length in detailed testimony. The Court is respectfully referred to pages 122-125 of the Record where petitioner testified categorically that no attempts were made to sell the film in 1946 or 1947, "that we practically abandoned the picture in '45", that "I would say that no effort was made at all," and " ... when I wrote it off in 1945, I just took it as a dead loss and figured that was the end of it, and if it hadn't been for that friend of mine, who, in spite of -- I mentioned it to him casually one time that I had this film, and he said, 'Well, I'd like to see it.'"

Indeed, this Court has held that subsequent recovery does not prevent proof of loss in a prior year.

Cahn v. Commissioner, 92 Fed. 2d 674
(9th Cir. 1937)

Rhodes v. Commissioner, 100 Fed. 2d 966
(6th Cir. 1939)

We submit that the detailed testimony cannot support a finding that petitioner did not abandon his efforts to sell the film at the end of 1945, and we submit that petitioner is

ntitled to a loss for that year. In the language of the pplicable regulation, the loss was "evidenced by closed and ompleted transactions, fixed by identifiable events, bona ide and actually sustained during the taxable period ..." J. S. Treasury Reg. 111, §29.23 (e) -1(b).

III

THE MOTION PICTURE 'WHITE FURY' BECAME WORTHLESS IN 1945 AND PETITIONER WAS ENTITLED TO DEDUCT THIS LOSS IN 1945.

A. Detailed Statement of the Facts.

The testimony dealing with the motion picture WHITE FURY is found in the following pages of the Transcript of Record: 99-108; 132-143; 150-151. The Findings of Fact of the Tax Court thereon are on pages 34-36. We believe the record is uncontradicted as to the following facts:

(1) Petitioner purchased the film in 1943. Total purchase price was $3,000.00, $500.00 of which he paid in 1943 and $2,500.00 of which he paid in 1945. (R. 99, 132) The bill of sale which he received was signed by one Thor Brooks who signed for and purported to have power of attorney for the corporate owner and for the president of the corporation; Brooks also signed the bill of sale in his own behalf (R. 99, 137). The film had been made in Lapland under

Swedish auspices and Brooks had been both director and producer. (R. 100) Petitioner believed Brooks had authority to sell the film. (R. 101).

(2) During 1944 and 1945 petitioner expended $7,000.00 more on the film to make it acceptable for English speaking audiences. (R. 100, 104) (The total amount of $10,000.00 is not contested. R. 105). The picture was ready for showing in 1945 (R. 100), and he was attempting to sell the rights in England.

(3) In 1945 representatives of the Swedish company Scandia Films informed petitioner and his proposed English vendee that the corporation which had produced and owned the film had gone bankrupt in 1939. (R. 102, 133; Resp. Ex. E). In addition, in 1945 Brooks himself "had to finally admit that apparently he had no right to make the sale." (R. 106, 139)

(4) Petitioner urged his prospective English vendee to oppose the legal proceedings instituted by the Swedish claimants in England in 1945 (R. 150-151). He testified:

"Q. How long did you continue to urge this opposition?

A. When the Swedish people got out an injunction and clamped down on the negative, which was in a laboratory in England, that was the end of all operations as far as the picture was concerned.

Q. This seizure did not occur until 1946.

A. The actual possession of the film perhaps was in '46 but the closing down on it, I believe, was in '45." (R. 151)

(5) During 1945 and with respect to the claims of the Swedish adversaries petitioner consulted his attorney "right along". (R. 134) His attorney advised him that he could not prevail in any litigation over the title to the film, that he was faced with long and expensive litigation, and that the best thing to do was to abandon the project. (R. 100-101, 134, 140-141). His attorney informed him that he had no rights. (R. 141).

(6) Petitioner determined in 1945 that his seller was financially unable to respond to any claim petitioner might make against him (R. 102, 138-140). Further, as the Government attorney put it, Brooks "virtually admitted that he perpetrated a fraud." (R. 139, and see R. 102).

(7) In December of 1945, petitioner's accountant made his book entry writing off the film as a loss. (R. 143) Petitioner's last expenditure on the film was in 1945 (R. 133), and in 1945 he abandoned all efforts with respect to that film. (R. 106-107, 108).

B. The Record Clearly Shows the Loss To Have Occurred in 1945.

Petitioner urges that this record cannot sustain the "finding" of the Tax Court that a loss did not occur in 1945 under §23(e). (R. 42). As shown by its opinion, the Tax Court believed that the evidence did not show a completed loss in 1945 because petitioner then did not affirmatively concede the correctness of his adversary's position and because actual seizure of the negative in England may not have occurred until 1946. (R. 44-45)

However, the law does not require that affirmative concession be brought home directly to the adversary. Here petitioner was advised by his own attorney to abandon the project and in the taxable year made his book entry and actually abandoned the film. He was not required either by the tax law or by common sense to shore up his record by an express writing to the Swedish claimants that he was abandoning the field to them.

As to the date of seizure, there are two obvious answers. First, whether petitioner suffered a loss in 1945 is not concluded by the fact, if so it be, that actual seizure did not take place until 1946 if in fact, as so it was, the adverse claim had been fully established in 1945 to the satisfaction of petitioner, his attorney and his proposed vendee and an

injunction had already been issued in 1945 in favor of the claimant.

Second, the record shows (despite the language of the Tax Court's opinion) that the seizure had taken place in 1945. See R. 106-107: "... the negative ... had been seized by the Swedish people, also, ..."

As shown by its opinion the Tax Court also believed that a completed loss in 1945 was not shown because "He may well have had a valuable claim against the person who sold him the picture ... He has not demonstrated the absense of any right to proceed against the unauthorized seller." (R. 45). Here too there are at least two answers: First, we believe it is clear on this record that petitioner's cause of action, if any, against Brooks was valueless. In such a situation, the law does not require the taxpayer to pursue his remedy to the limit before being allowed to take his loss. Rather, the converse is true: the taxpayer is entitled to take his loss and thereafter, if he recovers anything, he must report as income any recovery.

Burnet v. Sanford & Brooks Co.,
282 U. S. 359 (1931)

Niagara Shares Corp. v. Commissioner,
82 Fed. 2d 208 (4th Cir. 1936)

Commissioner v. John Thatcher & Son,
76 Fed. 2d 900, 902 (2nd Cir. 1935)

Commissioner v. Highway Trailer Co.,
72 Fed. 2d 913 (7th Cir. 1934)

Please see full discussion in the Niagara Shares case, supra, esp. page 211 of 82 Fed. 2d:

> "To postpone the settlement of the question of the amount of the taxes that should be paid until the end of the litigation over the guaranty contract would result in unnecessary delay and render uncertain the amount of the taxpayer's liability." 10/

Second, it is clear that Brooks perpetrated a fraud, and consequently petitioner must deduct his loss either when discovered or during the year of expenditure -- in this case 1945 with the exception of $500.00 paid in 1943.

Alison v. United States, 344 U. S. 167 (1952)

Borden v. Commissioner, 101 Fed. 2d 44 (2nd Cir. 1939)

It follows from all the above that petitioner was entitled to treat his investment in WHITE FURY as a loss in 1945. His action was properly governed by the rule of United States

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10/ The only case cited by the Tax Court on this point, H. D. Lee Mercantile Co. v. Commissioner, 79 Fed. 2d 391 (10th Cir. 1935), is clearly inapplicable. In that case, " ... the seller was a large responsible concern, amply able to respond for breaches of contract." (p. 392) "Nor does the record disclose any identifiable event by which to associate the loss with the 1927 tax year." (p. 393) "If there was a loss, the record is silent as to the amount of it ....." (p. 393)

v. S. S. White Dental Co., 274 U. S. 398, 403, and the other cases cited supra at page 38. Petitioner was not required to be "an incorrigible optimist" but could make a realistic appraisal of the situation, especially upon advice of his attorney.

Cahn v. Commissioner, 92 Fed. 2d 674, 676 (9th Cir. 1937)

Haywood Lumber & Mining Co. v. Commissioner, 178 Fed. 2d 769, 771 (2nd Cir. 1950)

CONCLUSION

For each and every of the reasons above stated, petitioners pray that the judgment of the Tax Court herein be reversed and that it be adjudged that there is no deficiency in income tax for the year 1945 with respect to Betty Finney or Edward F. Finney.

Respectfully submitted,

PAUL P. SELVIN and

IRVING ROGOSIN,

Attorneys for Petitioners.

APPENDIX A

Copy of Petitioner's Exhibit 2

C
O
P
Y

Los Angeles, California
September 23, 1943

The Tax Court of the
U. S.
April 10, 1956

Andrew Stone Productions, Inc.
Andrew L. Stone and
Frederick Jackson
Los Angeles, California.

Gentlemen:

This will confirm our understanding that all previous agreements heretofore entered into between us including but not limited to those agreements dated as of December 31, 942, March 10, 1943, and August 6, 1943, are rescinded nd cancelled and in addition to the salary of $12,000 for my services rendered in connection with the production of the notion picture photoplay Hi-Diddle-Diddle of which sum I ave heretofore received $3,000 and the remainder of 9,000 is to be paid to me concurrently with salary payments et to be made to Andrew L. Stone and Frederick Jackson as egative costs of Hi-Diddle-Diddle, are recouped, I hereby gree to sell to you or your nominees all capital stock now eld by me in Andrew Stone Productions, Inc., for the ollowing consideration, to-wit:

(a) In addition to the sum of $9,000 cash to be paid e from recoupment of the negative cost of Hi-Diddle-Diddle constituting deferred salary and hereinabove referred to) am to receive $5,000 in cash within three weeks of the ommencement of the principal photography upon the next icture to be produced by Andrew Stone together with the eferred payment of $2,500.00 payable within two years rom the release date of said picture and in addition thereto am to receive a cash payment of $5,000 within three weeks rom the commencement of principal photography upon the econd motion picture yet to be produced by Andrew Stone, nd an additional cash payment of $6,000 within three weeks rom the commencement of principal photography upon the hird picture yet to be produced by Andrew Stone for elease by United Artists under the existing distribution greement or any extension, renewal, replacement of ubstitution thereof.

(b) In addition to the cash payments hereinabove specified I am to receive directly from United Artists as distributor of Hi-Diddle-Diddle, 20% of the producer's net profits receivable by producer from the production and/or distribution of Hi-Diddle-Diddle and 12% of the producer's net profits receivable by producer from the production and/or distribution of each of the next three motion pictures produced by Andrew Stone for release by United Artists under the existing distribution agreement or any extension, renewal, replacement or substitution thereof. "Producer's net profits" is hereby defined as any and all sums directly or indirectly accruing or payable to the producer from the production and/or distribution of each of said motion pictures after deducting the following costs and expenses if legitimately and in good faith paid by the producer in connection with each of said motion pictures accounted for separately:

i. The cost of production of each of such motion pictures (subject, however, to the limitations hereinafter contained in paragraph numbered 1).

ii. All financing costs as such term is hereinafter defined in paragraph numbered 8 hereof.

iii. All administrative expenses connected with the business of producing, distributing and exhibiting the said motion picture, including legal and accounting expenses.

iv. All sums (not already deducted by the distributor) directly expended or incurred by the producer for prints, replacements, advertising, publicity, quota charges, imports, direct taxes on the motion pictures, film, and/or prints, and on the gross receipts.

v. The cost of supervising the distribution of the motion pictures and all overhead incurred in connection therewith.

vi. The costs and expenses of any litigation in connection with or relative to the production, distribution or exhibition of such motion pictures.

vii. All taxes including income and excess profits tax levied by the United States Government or any state or political subdivision thereof or foreign countries, excepting income taxes levied upon individuals based upon their distributive share of net income or individual capital gain.

1. In connection with the respective negative cost of the said three additional motion pictures yet to be produced by Andrew Stone and referred to in paragraph lettered (b) on the first page hereof, the amounts budgeted or paid for services of producer, director, writers, for story, and for screen play, shall individually approximate corresponding items budgeted for Hi-Diddle-Diddle but in no event (insofar as I am concerned) shall the aggregate exceed $80,000.00 for any of said pictures, and the excess above $80,000.00 shall not be charged as negative costs for the purpose of fixing and determining the net proceeds of 2% to be paid to me; provided, however, that the foregoing shall not apply insofar as you may legitimately and in good faith pay any amount or amounts in excess of $10,000.00 to any writers other than yourselves or for the purchase of any story or screen play written or procured from any one other than yourselves.

2. I consent to the pledge of my share of the residual values in Hi-Diddle-Diddle upon the same basis only as the pledge of all other residual shares as security for financing necessary to production of the second picture to be produced by Andrew Stone and I furthermore consent to the pledge of my share of the residual values upon the second picture yet to be produced by Andrew Stone for financing necessary to production of the third picture to be produced by Andrew Stone, upon the same basis as the pledge of all other residual shares, and I furthermore consent to the pledge of my share of the residual values in the third picture to be produced by Andrew Stone upon the same basis as all other residual shares, if it is necessary to pledge the same to secure financing to produce the fourth picture to be produced by Andrew Stone; it being understood that each of the respective pledges of residual shares hereinabove referred to shall not require the pledge of residual shares of standard Capital Company, Littner Associates, or any one other than yourselves and present and future stockholders of your producing companies and the phrase "necessary" as used above shall be deemed to mean necessary in your discretion.

3. I shall receive credit as Associate Producer upon Hi-Diddle-Diddle and separate credit as Associate Producer upon the department store story if hereafter produced by Andrew Stone as one of the three motion pictures yet to be delivered to United Artists, it being understood that such credit shall be on a separate frame of the motion picture and on all positive prints thereof, although any casual omission or inadvertent failure or act

by any one not within your control, shall not be deemed a breach thereof.

4. It is expressly understood that I shall not be obligated to render services of any nature whatsoever in the future and shall not be deemed to be an agent, partner, representative, associate or affiliate of yourself or any of the producing companies hereafter concerned with the production of said three motion pictures yet to be delivered to United Artists, and I shall be held free and harmless of and from all personal liability whatsoever in connection with the production and/or distribution of each of said pictures.

5. The aggregate sum of $20,000 invested by me in Hi-Diddle-Diddle shall be repaid from the recoupment of negative costs upon said motion picture together with interest at 6% from the dates of each advance made by me as soon as the prior liens of the banks, Standard Capital, DeLuxe Laboratories, and General Service Studios upon said motion pictures have been discharged, which sum of $20,000 may be paid directly for my benefit and on my account to the Bank of America National Trust & Savings Association as provided in that certain agreement executed with Standard Capital Co. dated March 18, 1943.

6. It is understood that I hereby release each of you from any claims, demands, causes of action, rights or obligations accured to the date hereof excepting only as expressly hereinabove defined and set forth and you do hereby release and forever discharge me of and from every claim, demand, cause of action, right or obligation accrued to the date hereof excepting only as expressly hereinabove defined and set forth, which you or either of you may have or hold against me.

7. Without in any manner restricting the personal obligations of Stone and Jackson hereinabove more specifically set forth and described, including the payment to me of each and every consideration more specifically set forth in paragraphs lettered (a) and (b) of the first page hereof, it is understood that insofar as Andrew Stone Productions, Inc. is concerned, this agreement is entered into as a compromise in good faith of a debt, claim, or controversy with myself as a stockholder thereof, and that no monies shall be paid to me by the said corporation except out of earned surplus, paid in surplus, or other surplus. It is further agreed that should it be desired to dissolve or liquidate Andrew Stone Productions, Inc.

hat I shall waive any objection thereto and do hereby give ny express consent to same, provided, of course that in he transfer of the motion picture Hi-Diddle-Diddle same hall be made subject to my rights as set forth in this greement, and the moneys to be paid to me shall be ubject to all other rights presently existing against the ame picture.

8. Wherever and whenever the term financing osts is used, such term shall be deemed to take into onsideration any interest, bonuses, percentage of profits, r other financing charges paid or to be paid in connection ith such motion pictures, including such items as those mounts paid to Standard Capital Company, and the ercentage of profits to Adolph Menjou on Hi-Diddle-Diddle, hat which is to be paid to Littner Associates under a resently existing contract dated July 10, 1943, and to all ther and similar items for such purpose that may be paid n good faith in the future, on the motion pictures included ereinabove.

9. The motion pictures referred to in this greement other than Hi-Diddle-Diddle shall specifically be nly the next three consecutive motion pictures produced by ndrew Stone for distribution through United Artists Corpora- ion under and pursuant to the existing agreement dated ebruary 2, 1943, between Andrew Stone Productions, Inc. nd United Artists Pictures Corporation or any extensions, enewals, substitution, or replacement of said agreement; t being expressly understood that I shall not be entitled to ny compensation or percentage or share of proceeds if ny of said pictures are not so produced, it being understood urther that I shall have no right to demand the production r delivery of such motion pictures.

Very truly yours,

APPROVED AND CONFIRMED:

Edward F. Finney

ndrew Stone Productions Inc.

By _____
President

_____
Andrew L. Stone, Individually

By _____
Secretary

_____
Frederick Jackson, Individually

The undersigned, United Artists Corporation, is not a party signatory to the foregoing agreement, but hereby accepts the provisions whereby it agrees to pay to Edward F. Finney directly that which is specified pursuant to paragraph lettered (b) of the first page of said agreement.

UNITED ARTISTS CORPORATION

By George A. Bagnall
Vice-President